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June 9, 2006

VIA HAND DELIVERY

The Honorable Charles L. A. Terreni
Chief Clerk & Administrator
Public Service Commission of South Carolina
101 Executive Center Drive
Columbia, South Carolina 29210

Re: Synthetic Fuels Partnerships Accounting Letter

Dear Mr. Terreni:

The purpose of this letter is to request, on behalf of South Carolina Electric & Gas Company ("SCE&G"), that the Commission amend the Accounting Letter it issued on June 21, 2000 related to the Company's investment in synthetic fuel partnerships. SCE&G participates in two such partnerships that manufacture synthetic fuel from coal. This fuel qualifies for Federal tax credits under Section 29 of the U.S. Internal Revenue Service Code.

As set forth in Order No. 2005-2, SCE&G has used the tax credits generated by these partnerships to defray the majority of the cost of the Saluda Dam Remediation Project, thereby reducing costs to electric customers. Pursuant to Commission Order 2005-698, SCE&G also used a small portion of the credits in the winter of 2005-2006 to extend bill assistance to qualifying low-income residential gas customers.

In the current request, SCE&G does not seek to change the allocation or use of Synthetic Fuel Tax Credits as approved in those orders. Instead, SCE&G seeks an amendment related only to the \$1.50 per ton discount that the partnerships have agreed to provide on the price of synthetic fuel sold to SCE&G's electric generation stations. (The discount is based on the per ton cost of coal before processing into synthetic fuel.) SCE&G seeks a suspension of the discount to allow the partnerships to continue to operate under current economic conditions. For reasons that are explained below, most other synthetic fuel producers have already shut down their activities. SCE&G's synfuel partnerships will be required to shut down their operations within the next week or two unless their costs of operations can be restructured.

The Federal Tax Code contains phase-out provisions applicable to Synthetic Fuel Tax Credits that are tied to the market price of oil. The Internal Revenue Service calculates the actual amount of the credit only after the close of the tax year, when the average oil price for the year is known. The high price of oil in 2006 has created a situation where credits will be drastically reduced. At this point, most synfuel producers can no longer generate sufficient credits to fund their costs of operations.

The synfuel partnerships in which SCE&G participates (in all cases as a minority partner) have relatively low operating costs. However, the partners cannot continue to operate them with their present cost structure and had been in the process of planning to shut them down. However, in the last several days, a proposal has been made, in lieu of an immediate shut down, to restructure the costs of the partnerships to allow them to continue to operate at least temporarily in hopes that oil prices will stabilize at a level that will sustain profitable operations.

In support of this agreement, several stakeholders in the partnerships have proposed that parties currently receiving benefits from the partnerships suspend collection of all or part of those benefits for the remainder of the calendar year. The suspended benefits would include royalties, operating margins for the plant operators, and the \$1.50 per ton discounts discussed above. The suspended benefits, including the \$1.50 per ton discounts, would be accumulated and when the IRS establishes the precise level of tax credits for the 2006 tax year in 2007, the suspended benefits would be funded pro rata before other credits are distributed to partners as profits. SCE&G would exercise all rights available to it as a partner to end the suspension as soon as market prices allow.

Proceeding with the proposal would require the Commission to approve the suspension of the \$1.50 per ton discount under the terms set forth above. The alternative would be to close down the partnerships and forfeit the opportunity to earn the discounts or additional tax credits that may materialize at the end of this year. Other costs of the partnerships are recognized outside of regulatory expenses, so there is no risk to electric customers from SCE&G participating in the partnerships under these terms.

The negotiations are not yet final but SCE&G must respond very shortly to the proposal made by the other partners in these partnerships to prevent shutdown. Accordingly, SCE&G specifically requests the Commission to act on this request no later than June 23, 2006. In addition, it is my understanding that the South Carolina Office of Regulatory Staff has no objection to this request and will be filing a letter with the Commission to that effect. The Office of Regulatory Staff would retain full audit rights as to these matters.

The Commission's authority to approve the requested accounting treatment is provided for in S.C. Code Ann. §58-27-1540 which defines the Commission's role in the establishing of accounts to be kept by electrical utilities under its jurisdiction and the manner of keeping such accounts. The Company believes that the Commission can render a decision in this matter without requiring a hearing because no change in rates is being requested. Also, the Commission, in ruling on similar requests in the past, has stated that approval of accounting

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treatments shall not prejudice the right of any party to take issue with the amount or with the accounting treatment of the costs in future rate proceedings.

Thank you for your consideration in this matter.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Belton T. Zeigler", with a long horizontal flourish extending to the right.

Belton T. Zeigler
Counsel for SCE&G

BTZ/abm

cc: Patricia B. Morrison, Esquire
Mr. Kenny R. Jackson
Mr. C. Dukes Scott
Mr. John W. Flitter